

IIEC PRELIMINARY RESPONSE TO FINAL POST 2006 ISSUES LIST

Power Procurement Issues

Power procurement issues are only relevant in the post-2006 era as they pertain to customers who are not receiving competitive supply and who rely on the electric utility to provide, or cause to be provided, electric supply. Consequently, it must be presumed that these customers are not good candidates for competitive supply, and procurement by electric utilities should be subject to regulatory oversight and protections that would otherwise be afforded to non-competitive service, consistent with the overall goals of the Public Utilities Act, (the “Act”) not just the provisions of Article XVI thereof.

As suggested in the very first question, energy acquisition in the post-2006 period should assure reliable supply, encourage adequate development of future resources, achieve the lowest rate and preserve the stability of rates. In addition, while it is not necessarily critical to promote efficient wholesale and retail competition, the procurement policies employed by the utilities certainly should not inhibit the development of efficient wholesale and retail competition. Stated another way, power procured for these remaining utility customers should not be artificially inflated in price in order to promote competition, for competition’s sake; rather, prices for serving these customers should be based on the actual cost of procurement, in whatever form that may take.

To the extent the utilities remain involved in the supply acquisition process, the ICC should have an ongoing role in overseeing the supply acquisition activities in order to ensure independent and equitable processes which serve to further the overall energy acquisition goals. As suggested in question #14, to the extent utilities continue to procure power for bundled service customers, they should do so through auctions, competitive bidding or similar acquisition processes in the context of

competitive wholesale markets. If wholesale markets are not truly competitive, it may be necessary to structure acquisition practices differently in an effort to minimize the detrimental impact on these customers.

It is important for there to be procedures in place for periodic review by the ICC of market structure and market rules to ensure they are consistent with the principles discussed above and not inhibiting competition in the forward and spot markets.

IIEC is generally supportive of procurement practices that promote the development of fuel diverse central station generation supply, demand response programs and, perhaps most importantly, development of cogeneration and distributed generation and removal of any barriers to their development.

Rate Issues

In the post-2006 period, the ICC will still have responsibility to ensure that regulated utility rates or other charges shall be just and reasonable, consistent with the longstanding directives contained in the Act. Exactly how this should be accomplished, of course, will be the subject of the workshops and the thoughtful discussion among the stakeholders, as well as the inevitable regulatory proceedings subsequent to this process. However, there are certain concepts to keep in mind throughout the process.

To the extent supply service continues to be provided by the utilities, the associated rates should cover their cost of providing the service. However, in as much as the Illinois utilities have divested themselves of their generating assets, provision of power supply should not become a profit center for the utilities in this event. The public interest will best be served if rates continue to be

established on a cost of service basis for those customers who did not have viable competitive alternatives. While there are provisions in the Act for deviations from cost of service, all tariffed rates should reflect cost of service at least until all barriers to entry to retail markets have been eliminated.

As the Act is now written, in the post-2006 period, rates are likely to reflect the cost of delivery as well as some commodity component. Consideration should be given to a FAC/PGA-type approach for these bundled rates. Rates could be set on the basis of a base power acquisition cost which could be adjusted through a true-up mechanism to reflect the actual power costs experienced by the utility. The pricing for this rate, of course, should be transparent to all customers and should allow the utility to earn the appropriate return on its distribution investment through the delivery service rate component and should not include subsidies.

It will be important to carefully balance the interests of customers and suppliers when determining the appropriate rates. Risks should not be unduly shifted from the supplier to the customer, or vice versa. However, within this framework, customers should have the option of prices that are set for a year based on then current market conditions, as opposed to being limited to an hourly price products, such as real-time pricing rates.

In any event, the ICC should be given the necessary authority to implement the post-2006 rates and that authority should be flexible enough that changes in associated markets and the electric energy industry can be accommodated, consistent with the overall objectives of the Act.

Competitive Issues

The level of competitive inroads made throughout Illinois has been disappointing. According to the most recent switching information available on the ICC website, less than 2% of nonresidential

customers are taking service from retail electric suppliers (including affiliates of the utilities). The load associated with these customers is somewhat higher (suggesting that customers on competitive supply tend to be relatively large). These results are disappointing given that competitive choice has been available for over 4½ years. IIEC has been and remains a strong advocate for the development of the competitive retail market in Illinois, consistent with the overall objectives of the Act.

The reasons for the lack of competitive inroads in the state are numerous and no doubt will be discussed at length in the context of the workshops. However, it can be expected that some customers are not likely to exercise competitive choice for the foreseeable future, irrespective of actions the ICC might take. Retail competition continues to be a desirable goal for customers. Yet, it should be recognized that the Commission has limited ability to have a significant positive impact on the competitive market while still remaining true to its other responsibilities under the Act.

As others have suggested, a competitive wholesale market will need to exist before a robust competitive retail market will exist. There are several prerequisites for a competitive wholesale market which includes, but is not limited to, the following:

- A liquid and transparent forward market throughout Illinois for electricity reaching out at least as far as the lead time for new generation and transmission construction.
- A liquid and transparent spot market available throughout Illinois for electricity allowing for fair and equitable settlement of retail and wholesale transactions.
- Forward and spot markets available throughout Illinois that reflect locational price differences to the extent there is transmission congestion, in order to encourage the siting of new generation and transmission facilities as needed.

- Resource adequacy requirements must be structured to ensure generating capability is actually built and must not inhibit retail competition.
- Market rules and structures must be in place that do not favor centralized markets over bilateral markets and which do not discriminate against retail customers.
- A single common market or its functional equivalent must be available for the entire Midwest.
- Finally, procedures must be in place for periodic review of market structure and market rules to ensure they are promoting reliability and not inhibiting competition in the forward and spot markets.

In order for a vibrant and competitive retail market to develop in Illinois, remaining barriers to retail market entry (e.g., CTC, reciprocity clause, etc.) must be eliminated so that a sufficient number of suppliers in a retail market are available to provide customers with a viable alternative to the local utility bundled service. (The reciprocity clause is a major barrier to market entry in Illinois and a potential barrier to the ability of end-use customers to participate in the market.) In addition, the identification and elimination of transmission restrictions within and leading into Illinois that serve as barriers to retail customer access to alternative suppliers must be eliminated.

The interests of customers in Illinois would be served best if all Illinois utilities were in the same regional transmission organization (RTO); however, given recent Federal Energy Regulatory Commission orders, this goal does not appear attainable. Nevertheless, IIEC continues to recommend full participation of all Illinois utilities in RTOs by no later than January 1, 2005.

It will be important for the ICC to be given increased authority to periodically review and modify retail market structures and rules to ensure reliability and workable retail competition. A key part of this will be the identification and mitigation of remaining generation market power. It will also be important to establish more realistic standards for determining whether a bundled service is truly competitive before allowing a utility to abandon it, or close it to new or returning customers.

The ICC should be given authority to develop certain methods and procedures for measuring the existence of competition. These could include, but are not necessarily limited to, the following:

- Market power tests such as the Herfindahl-Hirschman Index test;
- review of customer switching statistics;
- development of customer surveys;
- identification of the number of supply offers; and
- identification of entities actually scheduling and flowing power over the transmission system.

The affiliate rules between Illinois utilities and their parents and affiliated companies need to be strengthened to ensure that Illinois utilities take action consistent with the interests of the utility customers. The integrated distribution company approach that seems to be favored by most utilities has not proven to increase the competitiveness of markets, but rather seems to have simply decreased options for customers in the face of limited viable competitive alternatives and has resulted in decisions related to utility operations that seem to be made on the basis of furthering the interests of unregulated affiliates. The Commission should reevaluate its rules in this regard for potential change.

Utility Service Obligations After 2006

The Act as it is currently written, requires the incumbent utilities to offer a form of bundled service to all small commercial and residential retail customers after the end of the mandatory transition period under Section 16-103(c), at rates which reflect the recovery of all cost components for providing the service. However, if a component of that service has been declared competitive, the cost of providing that service is to be based on market based prices. The market based price for electric power and energy will either be: (1) the price of electric power and energy as determined under Section 16-112 or, (2) the electric utility's cost of obtaining that electric power and energy at wholesale through competitive bidding or other arm-length acquisition processes. (220 ILCS 5/16-103(c)).

All other customers will be entitled to bundled service until the service has been declared competitive or abandoned. (220 ILCS 5/16-103(a)).

After the mandatory transition period, in setting rates and charges for tariffed services (including bundled services), the Commission is to consider only certain things, including, but not limited to, the current or projected revenues, costs, investments and cost of capital directly or indirectly associated with the provision of the tariffed service. It is prohibited from considering certain things such as revenues, costs and investments or cost of capital of the electric utility or any affiliate of an electric utility that are not associated with the provision of tariffed service. The Commission is to equitably allocate joint and common costs and investments between the electric utility's competitive and tariffed services. In determining whether or not the electric power and energy component of the utility's rate for tariffed services is just and reasonable, after the transition period and before the provision of electric power and energy is declared competitive, the Commission is to determine the extent to which the electric

power and energy component of the tariff service rate exceeds the market value established under Section 16-112 by more than 10% for any customer class and is permitted to establish the electric power and energy component at a rate equal to that market value plus 10%. (See 220 ILCS 6/16-111(i)). Therefore, the Act identifies the utility's load serving obligations after 2006.

IIEC generally believes that Provider of Last Resort/Default Service (POLR) could be furnished by an entity other than the utility or its affiliate and that customers may be better off if such service is bid. Current market conditions suggest the service should be available to all customer classes and on a statewide basis.

The POLR offering should allow the provider to recover the cost of purchasing the power in the market and customers should have the option of a fixed one year price or prices that vary under seasonal or monthly conditions, not just an hourly price. POLR offerings should be structured uniformly by class across the State.

RTO development should not affect the POLR choice by the customer, but may affect the type of POLR service offered.

The POLR provider should not necessarily have to be an Alternative Retail Electric Supplier. If the utility is the POLR provider, it should be allowed to recover the cost of purchasing power in the market to meet the POLR requirements. As mentioned above, until such time as all barriers to entry into the retail market (by suppliers and customers) has been eliminated, such rates should reflect the cost of the service.

Energy Assistance

When the General Assembly adopted the Customer Choice and Rate Relief Law of 1997, it addressed the issue of energy assistance by creating a supplemental low-income fund (305 ILCS 20/13). This low income energy assistance is currently funded by a surcharge on all end-use customers' electric bills and gas bills within the State of Illinois. Thus, Illinois already has developed a mechanism to help low income customers who cannot otherwise afford to pay their electric and gas bills. The General Assembly has periodically reviewed this legislation and has enacted amendments thereto. This appears to be an on-going concern, and as such, it is not necessarily related to Post 2006 issues. To the extent these issues are addressed, the current statutory framework should be maintained and any increased funding should come from sources other than customer surcharges.

In the past, economic development rates have been approved by the Commission because they have had a beneficial impact on Illinois. Such rates encouraged the location of businesses within Illinois, thereby increasing employment and tax revenues for the state. The fundamental principle underlying this approach has been that such rates are set above the utility's marginal cost of production, but below the tariffed rate. Under that circumstance, the customers receiving the benefit of these rates made a substantial contribution to the utility's fixed costs (i.e., allowed the utility to spread its fixed costs over a greater number of customers and a larger amount of electrical load). These rates were approved under the assumption that customers would not otherwise locate within the State of Illinois but for the provision of such a rate. Since Illinois utilities no longer own generation, economic development rates structured in the traditional sense could require that existing customers subsidize beneficiaries of the economic development rates with no corresponding benefit of allowing the utility to spread its fixed

cost of production over a greater amount of load. Accordingly, there may not be an appropriate role for traditional economic development rates in the post transition marketplace.

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